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FINANCIAL INSTITUTION E-BRIEF

The Devil is in the Details...

A recent bankruptcy court decision in Nebraska provides a reminder to lenders of the importance of paying attention to details when perfecting, as well as releasing, the lender's security interest in collateral.

The court describes the factual background as follows: the debtor initially obtained a loan from Lender A in December 2003 that was secured by a deed of trust and guaranty. Without a security agreement in place, in June and July 2003, Lender A filed financing statements reflecting a blanket lien on debtor's assets. The debtor obtained a second loan from Lender A in May 2006. The 2006 loan was secured by a commercial security agreement covering essentially all of debtor's assets, a deed of trust, and a guaranty.

In 2007, the debtor sought a revolving loan from Lender B that was to be secured by certain equipment. Lender B requested payoff figures for the UCC financing statements filed by Lender A. The payoff request letter from Lender B noted that upon receipt of funds "for the **entire** payoff of **all** accounts that you agree to terminate your security interest in **all** of the collateral" and requested that Lender A consent to the filing of certain UCC amendments to effectuate the termination of Lender A's security interest. Attached to Lender B's payoff request letter was an 8-page listing of equipment and other personal property of the debtor. Lender A signed the consent and issued a letter stating the requested payoff amount for the 2006 loan and noting "**all**

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liens would be released” upon payoff. Lender B provided the full payoff amount for the 2006 loan to Lender A and filed the amendments to Lender A’s financing statements to effectuate the terminations.

The debtor filed for bankruptcy in 2009 and a dispute arose among creditors with respect to whether Lender A had a security interest in debtor’s personal property securing the 2003 loan and whether the UCC financing statements filed by Lender A in 2003 were in fact terminated.

Ensure All Necessary Security Documents are in Place to Secure Collateral.

In the bankruptcy proceedings, Lender A claimed an interest in the debtor’s personal property at issue as security for the 2003 loan. Despite Lender A’s claim of a security agreement securing Lender A’s interest in essentially all of debtor’s property, there was no security agreement in place securing the 2003 loan. Consequently, as to the 2003 loan, the only security interest in personal property securing the 2003 loan was Lender A’s deed of trust which only covered personal property attached to the real property collateral, and not the personal property at issue in the bankruptcy case.

Review and Respond to Payoff Requests Carefully.

Lender A also claimed it had intended to only release its interest as to the equipment identified in the 8-page attachment to Lender B’s payoff request letter and that its UCC financing statements had been improperly terminated. The court dismissed such claims, finding Lender B’s payoff request letter and Lender A’s response unequivocally made reference to “all” accounts, “all” collateral, and “all” liens. Further, by Lender A’s own admission, Lender A’s response appeared to consent to the release of all liens securing the 2006 loan and not just the listing of equipment attached to the payoff request letter. The court also concluded that upon payoff of the 2006 loan, Lender A’s security interest in the collateral, as a result of the 2006 loan, was extinguished and questions with respect to the termination of the UCC financing statements were irrelevant. Consequently, Lender

A did not have a security interest in the personal property at issue in the bankruptcy proceedings securing Lender A's 2003 loan.

In summary, the above case provides two very important reminders. First, make sure the lender and/or its legal counsel have prepared and the debtor has executed all documents necessary to adequately secure the lender's interest in any and all collateral. Second, in managing a loan, review payoff requests carefully in order to understand what exactly is being requested and to ensure an appropriate response to the exact request is made. A little foresight, together with careful management of the loan, is essential in protecting a lender's security interest in collateral.

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